



THE CITY OF SAN DIEGO

DATE: April 7, 2010

TO: Honorable Members of the Audit Committee

FROM: Eduardo Luna, City Auditor

SUBJECT: **Option to Review the Gainsharing Goals for Public Utilities Department Bid to Goal (B2G) Programs**

At the request of the Audit Committee, we met with Public Utilities Department officials and representatives from AKT Certified Public Accountants, LLP (AKT)—the external auditor for the B2G programs—to discuss the feasibility of auditing B2G gainsharing goals. Based on these discussions and our assessment of this issue, for your consideration we are providing an option to further improve the credibility and transparency of the program and help ensure that goals are reasonable and challenging.

Current Scope of External Audits for B2G Program

The Audit Committee recently approved the Public Utilities Department's contract with AKT for an external audit of the Wastewater Fund and Water Customer Support Division B2G Programs.¹ The scope of work includes sampling and testing the Department's reported (1) savings calculations, (2) gainsharing goal achievement, and (3) payouts. AKT audits are conducted after the fiscal year ends and savings and goal achievements are calculated by the Department.

Our Evaluation of Gainsharing Goals

During our recent audit of the B2G program, we evaluated a sample of gainsharing goals for fiscal years 2008 through 2010. We found that, while fiscal year 2008 and 2009 goals lacked sufficiently detailed descriptions and benchmarks for determining whether they were stretch goals, the measurability and auditability of fiscal year 2010

¹ AKT (formerly GLT), a certified public accounting firm, has provided external audit services of the water and wastewater departments' B2G programs since fiscal year 2005. Note that the draft Memorandum of Understanding for the proposed Water Fund B2G program will be presented to the Independent Rates Oversight Committee on April 21, 2010 and is expected to be presented to the City Council Rules Committee in May or June.

goals have improved. For example, the goal summaries contained more robust and detailed information in the “Justification of Challenge Level” and “Relevance” sections which, in some cases, provided links to regulatory requirements and benchmark information to help us determine whether it was a stretch goal. We attributed these improvements to specific guidance and coaching provided to management prior to and throughout the goal development process and recommended that the Department ensure that future goals continue to be measurable, auditable, and stretch goals.

Option to Improve Goal Credibility and Transparency

Based on our discussions with Department officials and AKT representatives, we have identified a potential solution for the auditing of gainsharing goals that we believe will provide the most benefit to the City. To improve the transparency and credibility of the B2G program and help to ensure that goals are reasonable and challenging, we suggest that the Department:

1. Expand the “Justification of Challenge Level” and “Relevance” sections of the gainsharing goal summary sheet to include detailed information on why the goal is challenging, including providing industry benchmark data, if appropriate, and providing supporting documentation for the level of difficulty.
2. Increase the scope of work in its contract with AKT to include evaluating gainsharing goals before they are approved. Specifically, this would involve reviewing goals for measurability and Justification of Challenge Level; determining whether supporting documentation is sufficient; and providing input when appropriate for improving the measurability and challenge level of goals.

Because many of the Program’s goals are technical and specific to the water and wastewater industries, a more detailed audit of goal setting than this would require engineering expertise, such as hiring an engineering consultant. However, after our discussions with Department officials and AKT representatives, we do not believe this level of review is necessary or worth the additional cost to the City at this time. This is largely because Department managers and other employees will derive a unique benefit from providing additional justification and supporting documentation on a goal’s challenge level and help the Department to improve managers’ and employees’ industrial knowledge and expertise in developing measurable and auditable goals. In addition, we believe that this proactive approach toward goalsetting, which includes using AKT’s experience assessing the measurability and auditability of goals before they are approved, will provide the desired results of ensuring appropriate stretch goals. In order for AKT’s testing of goals to add the greatest and most immediate benefit, it should begin with fiscal year 2011 goals, which have recently been developed by the Department.²

² Payouts for fiscal years 2009 and 2010 goals are based on the current Memorandums of Understanding and will not be impacted by testing the level of challenge of the goals. Also, as discussed above, we concluded that fiscal year 2010 goals summaries contained more robust and detailed information in the “Justification of Challenge Level” sections.

During our discussions with Department officials and AKT representatives, they agreed that this is would be the most beneficial solution. We believe it is the responsibility of Department management to identify the appropriate percentage of goals to test and finalize the terms of AKT's contract. AKT will perform a preliminary evaluation of a sample of goals and discuss its findings with management to help determine the extent of testing. We should note that we compiled the information contained in this memo based on discussions with AKT and Department staff, but that we did not audit this information or conduct an additional performance audit of the B2G program.

Respectfully Submitted, _____

A handwritten signature in cursive script that reads "Eduardo Luna". The signature is written in dark ink and is positioned above a horizontal line.

Eduardo Luna
City Auditor

cc: Jay M. Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Ken Whitfield, City Comptroller
Alex Ruiz, Acting Public Utilities Director
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